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NO. _____

IN THE

Supreme Court Of The United States

NO. 89-1384

_____ TERM, 1990

ERNEST ROSS, ET AL.,
Petitioner

v.

BANK SOUTH, N.A., et al.,
Respondents

GEORGE MILLER, ET AL.,
Petitioner

v.

ARTHUR M. RICE, JR., et al.,
Respondents

SUPPLEMENTAL APPENDIX

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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SUPPLEMENTAL APPENDIX

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

ERNEST ROSS and GEORGE MILLER, Individually and as representatives of a bondholder class,	)	
Plaintiffs,	)	
v.	)	CONSOLIDATED CIVIL ACTION NOS. CV85-PT-0444-S CV85-PT-1044-S
ARTHUR RICE, JR., et al.,	)	
Defendants.	)	

MEMORANDUM OPINION

This cause comes on to be heard on a myriad of motions for summary judgment filed by all remaining defendants and several motions for summary judgment filed by plaintiffs. The record reflects that all such filed motions are now under submission for consideration by the court.[1] This opinion should be considered as one of a continuum of opinions and recorded discussions addressing these various motions and previous similar motions. This court will not fully restate principles and conclusions previously stated in prior opinions and oral discussions.

As is usual in cases involving multiple defendants and claims, it is difficult to focus on the issues as they specifically relate to each defendant. Still, this court will make the effort. Where the issues apply to all defendants, this court's discussion will have general reference to all defendants.

The court is mindful of the various restraints, constraints, admonitions, etc. applicable to a consideration of motions for

[1] The parties so acknowledged at a recorded hearing on July 30, 1986.

summary judgment and will not repeat them here. On the other hand, the various enunciated principles applicable to consideration of motions for summary judgment cannot be applied in such a Procrustean manner as to allow an abdication of this court's duty to review the evidence. Plaintiffs argue that, "The main reason why summary judgment is not available is that all six issues are factual and, as such, solely the province of the jury. Questions of knowledge and intent are particularly inappropriate for the jury." If such abstract mouthings were the sole answer, the court would not even have the obligation to examine the evidence. This court believes that its prerogatives do not include such a dereliction. This court also assumes that it is inappropriate, in any case, for juries to make *ad hoc* determinations with reference to what are actually questions of law or to act as a final arbiter merely because the *law* is uncertain or difficult to apply. Notwithstanding the record developed during the July 30, 1986 hearing, the Statue of Liberty does not symbolize that lay jurors are to act as lawyers or judges. At the July 30 hearing, plaintiffs' lead counsel stated that he ultimately settled most cases of the type now before this court. Perhaps that is even more reason for this court not to abdicate its responsibility even though such settlements eliminate the possibility of error and also considerably reduce the burden this court has imposed upon itself in reading and re-reading the record and the briefs. This court is mindful, however, of Judge Skelly Wright's observation:

> These generalizations do not, however, relieve courts of their responsibility to decide whether a genuine issue of fact exists. That doubt concerning the issue should be resolved against the movant may assist courts in disposing of troubling cases after deliberation, but it provides no assistance in the deliberative process itself. That state of mind should generally be a jury issue does not mean it should always be so in all contexts, especially where the issue is recklessness, which is ordinarily inferred from objective facts. Summary judgment serves important functions which would be left undone if courts too restrictively viewed their power. Chief among these

> are avoidance of long and expensive litigation productive of nothing, and curbing the danger that the threat of such litigation will be used to harass or to coerce a settlement. Asbill & Snell, *Summary Judgment Under the Federal Rules — When an Issue of Fact is Presented*, 51 Mich. L. Rev. 1143, 1144 (1953).

Washington Post Co. v. Keogh, 365 F.2d 965, 967-68 (D.C. Cir. 1966) (footnote omitted), *cert. denied*, 385 U.S. 1011 (1967).

In the final analysis, the real issue facing this court is whether there is legal evidence sufficient to create a reasonable inference for jury consideration as to each essential element of plaintiffs' claims against each defendant. If so, the next question is whether there is disputed evidence which precludes an adoption of asserted defenses as a matter of law. This court also acknowledges the standard enunciated in *Celotex Corp. v. Catrett*, 106 S. Ct. 2548 (1986). This court expects either to include statements of opinion pursuant to 28 U.S.C. § 1292(b) or to direct the entry of final judgment pursuant to Fed. R. Civ. P. 54(b). In view of this, the court will attempt to focus on the issues as to make any mistakes of law apparent.

At the July 30 hearing, the plaintiffs acknowledged that their claim(s) of liability are premised on three primary theories.[2] These theories are: (1) that the issuance of the bonds resulted from a fraudulent scheme to issue non-marketable bonds premised on an unfeasible project;[3] (2) that the issuance of the bonds resulted from a fraudulent scheme to issue bonds, interest on which was represented to be tax exempt when in fact it was not; and (3) that the issuance of the bonds resulted from a fraudulent scheme to issue bonds which were invalid because of non-compliance with the pertinent authorizing state law, i.e., Rice controlled the issuing authority.[4]

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[2] This representation is general consonant with the arguments of plaintiffs in their various briefs.

[3] As will be indicated, plaintiffs argue that this theory is supported by various categories of evidence.

[4] (2) and (3) are interrelated in that compliance with state law bears on the tax exempt status of the bonds. Plaintiffs argue, however, that 26

There are various grounds which most, if not all, defendants generally rely upon.

These various grounds asserted by the defendants are as follows:

I. *As To Claim That Defendants Fraudulently Schemed To Issue Bonds As Being Tax Exempt When They Were Not*

Defendants argue that:

A. The plaintiffs have not paid any taxes on the interest earned on the bonds, no assessment has been made for unpaid taxes on interest, and no demand has been made or collection action taken by IRS, nor has any position been taken by IRS that taxes are due. To the contrary, IRS has recognized Mt. Royal Towers, Inc. as being a tax exempt organization and has never changed its position in that regard. Thus, the plaintiffs have suffered no injury based on this alleged claim. Only plaintiffs and their counsel, for purposes of this action, have questioned the tax status of the bond interest. Even if the interest was taxable, it was at a high rate and the bonds could have been marketed at some price. There is no evidence of a conspiracy or scheme as to this or any other issue.

B. This court does not have jurisdiction or authority to adjudge or declare whether the interest on the bonds is tax exempt. Both 28 U.S.C. § 2201 and 26 U.S.C. § 7421(a) preclude this court's looking behind the IRS determination of the issue.

II. *As To Claim That The Bonds Were Not Marketable*

Defendants argue that:

The bonds were clearly marketable. The defendants used sixteen (16) million dollars to purchase and construct the project and eleven million dollars to repay the invested bondholders. Ross invested $10,197.00 and has received $11,350.00. Miller invested $143,134.00 and has received

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U.S.C. § 501 (c)(3) both overlaps but also transcends the consideration of state law. Plaintiffs also argue that the bonds were not exempt from registration. At *this* writing, this court is uncertain whether this latter argument directly relates to tax exempt status, the violation of state law, or both.

$157,050.00. In total, the bondholders received 103.69% of the amount invested, exclusive of tax benefits. The project's bonds were marketable subsequent to bankruptcy when the trustee recovered 70 cents on the dollar. Bondholders had been paid significant additional amounts prior to bankruptcy. The bondholders have received a total of thirty-four million dollars. However, under *Shores v. Sklar*, 2647 F.2d 462 (5th Cir. 1981), bonds must not be marketable at all. The bonds are represented as risk bonds and, thus, called for a higher than market rate of tax exempt interest. The very results obtained clearly demonstrate that the bonds were marketable at some price. Even if the bonds were speculative, they were marketable at some price. The high rate of interest (17%) demonstrated the risk nature of the bonds. The bonds were obviously not "thoroughly tainted by fraud." There was no "pervasive scheme," as the bonds could obviously be marketed at some price. If bonds were legitimate or valid, the plaintiffs cannot prevail.

III. *There Is No Evidence Of Scienter Or Conspiracy*

Defendants argue the thrust of plaintiffs' complaint is that, based on facts known to the defendants, the project could not succeed. However, *Shores v. Sklar*, requires proof of scienter and a conspiracy. There is no evidence of bad faith, intent to defraud or scienter. Plaintiffs rely merely upon the project's failure coupled with the participation of the defendants. That is not enough. The mere partial failure of a project does not evidence its compensability.

IV. *There Is No Proof Of A Pattern Of Racketeering Activity To Support A RICO Claim*

Defendants argue that, if there is no intent to deceive or defraud, there can be no pattern of racketeering. In any event, there is no "pattern" of racketeering and, thus, no maintainable RICO claims against certain defendants under section 1962 (a) and (b).

V. *The Action Is Barred By The Statute Of Limitations*

Defendants argue that the statute of limitations for section 10b-5 claims is two years (citing *White v. Sanders*, 650 F.2d 627 (5th Cir. 1981)) and one year for RICO claims (citing 735

F.2d 1175). Defendants argue that plaintiffs knew more than two years before the filing of this action that the project was behind schedule, with Miller phoning Bank South to inquire about project problems.

VI. *Plaintiffs Have Suffered No Damages*

Defendants argue that plaintiffs have received more than they invested.

VII. *Plaintiffs Are Attempting To Take A Position Inconsistent With That Taken During Bankruptcy Proceedings*

Defendants argue that, during the bankruptcy proceedings, the plaintiffs claimed and received priority as secured creditors based on their position that the defendant validly issued their bonds. In contrast, they now argue that the bonds were invalid under state law.

VIII. *Non-Reliance*

Defendants argue that plaintiffs did not rely on the integrity of the market.

IX. *Lack Of Participation, Lack Of Control, Etc.*

Various defendants argue that, even assuming another basis for liability, their roles were insufficient to establish either primary or secondary liability.[5]

X. *There Is No Implied Private Right Of Action Under § 17(a)*

This court begins its analysis by rather summarily denying several of the grounds asserted by defendants, none of which are dispositive of the motions. First, this court concludes that there is a disputed issue of fact as to when the alleged cause(s) of action accrued. This court cannot determine, as a matter of law, that plaintiffs had notice or knowledge outside the limitations period(s) which resulting in the accrual of the action(s).

Further, the court rejects defendants' argument that plaintiffs cannot recover as they have suffered no damages. Plaintiffs cite *Huddleston v. Herman & MacLean*, 640 F.2d 534, 553-56 (5th Cir. 1981), *aff'd in part on other grounds and remanded*, 459 U.S. 375 (1983) for the proposition that the

[5]This is argued as a pure question of law.

measure of damages is the difference between the price paid for the security and its "real" value at the time, unaffected by subsequent factors unrelated to the alleged fraud. Defendants also cite *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 189-91 (3d Cir. 1981) and other case for the same proposition. Notwithstanding the correctness of defendants' assertion as to the proper measure of damages, this court concludes that there are legitimate issues of fact related to whether any reduction in value resulted from interest rate changes, unforeseeable increases in construction costs or similar post-closing factors, or whether any decreases in value resulted from the unfeasibility of the project or other factors existent at the time of closing.[6] This court further concludes that the mere fact that the plaintiffs recovered more than their principal outlays is indeterminative, as a matter of law, of whether they suffered any damages. The loss of use of money is an appropriate concern if, in fact, the "real" value of the bonds did not equal their purchase price at the time of issue.

A recent Supreme Court decision indicates that alleged tax benefits cannot be considered as a reduction in damages. *See Randall v. Loftsgaarden*, 106 S. Ct. 3143 (1986). *Randall* discusses whether a recissionary measure of damages is available under section 10 (b). However, the Court did not specifically resolve this issue. At present, it is unnecessary for this court to determine whether *Randall* applies to this case. This court notes that there is no evidence of damage directly resulting from the claims that either the bond interest is taxable or that the bonds were not validly issued.

Defendants' arguments as to non-reliance have already been addressed by the court in its opinion filed on February 25, 1986. For the reasons stated there, this court concludes that there is an issue of fact as to non-reliance.

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[6]The fact that we are concerned with first mortgage bonds rather than common stock makes it less likely that post closing factors other than increases in interest rates, if any, would affect the value of the securities. The court is assuming, for the purpose of the instant analysis only, that there is a disputed issue of fact as to the feasibility claim.

Defendants' argue that this court should estop the plaintiffs from asserting the invalidity of the bonds as the latter took advantage of secured creditor status in Bankruptcy Court. This court notes, however, that any position taken by plaintiffs in Bankruptcy Court does not prejudice any of these defendants. To the contrary, the defendants may benefit from the commensurate reduction in damages which may be claimed here. Furthermore, the defendants have not demonstrated that the Bankruptcy Court proceedings involved any adversarial relationship between plaintiffs and any of these defendants. Thus, this court concludes that the defendants cannot prevail on this defense.

The court *will* give short shrift to defendants' argument that plaintiffs may not raise the issue of tax exemption *vel non* because of the application of 28 U.S.C § 2201 and 26 U.S.C § 7421 (a). Neither plaintiffs nor defendants cite cases specifically concerning whether this court may consider the issue of tax exemption in a securities action. 26 U.S.C. § 7421 (a) provides that "no suit for the purpose of *restraining the assessment* or *collection* of any tax shall be maintained" and, thus, has no apparent application to this issue. This case obviously does not involve any attempt to *restrain* the *assessment* or *collection* of any tax.

While the language of section 2201 is broader than that of section 7421 (a), this court is satisfied that it must consider section 2201 in relation to Section 7421 (a) and that both effectively bars only declaratory relief sought for the purpose of restraining assessment or collection of taxes. *See Church of Scientology of Celebrity Centre Los Angeles v. Egger*, 539 F. Supp. 491 (D.D.C. 1982). Section 2201 applies to cases wherein a party questions the right of a taxing authority to impose taxes. *See* cases cited in *Egger*, 539 F. Supp. at 494. *See*, however, *Abortion Rights Mobilization, Inc. v. Regan*, 544 F. Supp. 471 (S.D.N.Y. 1982); *DuPont v. Southern National Bank of Houston, Texas*, 575 F. Supp. 849 (S.D. Tex. 1983), *modified*, 771 F.2d 874 (5th Cir. 1985); and *Vietnam Veterans Against the War, Inc. v. Voskull*, 389 F. Supp. 412 (E.D. Mo. 1974). *DuPont* may well support this court's ultimate conclusion that a jury should not determine the tax status of the bonds, at least under the facts of this case. *See DuPont*, 575 F. Supp. at 861

n.5. This court concludes that neither of the cited statutes bars the plaintiffs' claim on the issue of tax exemption *vel non.* While there may be doubt as to whether a jury should decide such an issue, whether tax exemption *vel non* should be an issue in the absence of any revocation of tax exempt status by I.R.S., or whether there is a factual issue of conspiracy or fraudulent scheme related thereto, the court is satisfied that neither of the cited sections has application.[7] This court concludes that while the jury may not be allowed to determine the issue of tax exemption in the absence of compelling evidence that the issue *was not* tax exempt and that defendant(s) actually knew it, the court will not grant the defendants' motion on the issue of statutory bar.

Continuing in the vein of considering the issues as to which the court has experienced least difficulty in considering and resolving,[8] the court turns to plaintiffs' RICO claims. It is apparent that the sole basis for RICO claims against all moving defendants except Hereth, Orr and Jones, Inc., Jack Hereth and Peter Orr is based on the alleged fraudulent scheme in this case.

In *Sedima, S.P.R.L. v. Imrex Co.*, ___ U.S. ___, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985), the Court stated:

> As many commentators have pointed out, the definition of a "pattern of racketeering activity" differs from the other provisions of § 1961 in that it states that a pattern "requires at least two acts of racketeering activity," § 1961(5) (emphasis added), not that it "means" two such acts. The implication is that while two acts are necessary, they may not be sufficient. Indeed, in common parlance two of anything do not generally form a "pattern." The legislative history supports the view that two isolated acts of racketeering activity do not constitute a

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[7]Rice makes the specious argument that, even though the IRS is not a party, "If the court declared the bonds tax exempt . . . this would enjoin the Internal Revenue Service from making any further determination of the status of the bonds." No party has made any argument about the possible effect of 26 U.S.C. § 7428.

[8]This should not suggest that this court's resolution of even these issues is infallible.

> pattern. As the Senate Report explained: "The target of [RICO] is thus not sporadic activity. The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a pattern." S. Rep No. 91-617, p. 158 (1969) (emphasis added). Similary, the sponsor of the Senate bill, after quoting this portion of the Report, pointed out to his colleagues that "[t]he term 'pattern' itself requires the showing of a relationship. . . . So, therefore, proof of two acts of racketeering activity, without more, does not establish a pattern. . . . " 116 Cong. Rec. 18940 (1970) (statement of Sen. McClellan). See also id., at 35193 (statement of Rep. Poff) (RICO "not aimed at the isolated offender"); House Hearings, at 665. Significantly, in defining "pattern" in a later provision of the same bill, Congress was more enlightening: "criminal conduct forms a pattern if it embraces criminal acts that have the same or similar purposes, results, participants, victims or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events." 18 USC § 357(e) [18 USCS § 375(e). This language may be useful in interpreting other sections of the Act. *Cf. Iannelli v. United States,* 420 U.S. 770, 789, 95 S. Ct. 1284, 43 L. Ed 2d 616, (1975).

87 L. Ed 2d at 358-59 n.14.

Further that:

> We nonetheless recognize that, in its private civil version, RICO is evolving into something quite different from the original conception of its enactors. *See* generally ABA Report, at 55-69. Though sharing the doubts of the Court of Appeals about this increasing divergence, we cannot agree with either its diagnosis or its remedy. The "extraordinary" uses to which civil RICO has been put appear to be primarily the result of the breadth of the predicate offenses, in particular the inclusion of wire, mail, and securities fraud, and the failure of Congress and the

> courts to develop a meaningful concept of "pattern." We do not believe that the amorphous standing requirement imposed by the Second Circuit effectively responds to these problems, or that it is a form of statutory amendment appropriately undertaken by the courts.

87 L. Ed 2d at 361.

Since *Sedima,* a number of courts have responded to the Court's invitation to develop a "meaningful concept of 'pattern'." Those cases have uniformly held that the mere allegation or proof of two or more predicate acts as a part of a single scheme is insufficient if there is no demonstrated threat of continuity. This court sees no reason to further expand on the well-stated opinion of Judge Freeman in *Sheftelman v. Jones,* 636 F. Supp. 263 (N.D. Ga. 1986). *See also Soper v. Simmons International Ltd.,* 632 F. Supp. 244 (S.D.N.Y. 1986); *Northern Trust Bank/O'Hare, N.A. v. Inryco Co., Inc.,* 615 F. Supp. 828 (N.D. Ill. 1985). *See also* in *Sedima,* 105 S. Ct. at 3289-90 (Powell, J.). *See also* cases cited in *Soper.* This court believes that Judge Freeman's statements distinguishing *Bank of American National Trust & Savings Ass'n v. Touche Ross & Co.,* 782 F.2d 966 (11th Cir. 1986) are applicable here. This court concludes that all defendants' motions for summary judgment addressed to the Civil RICO claims are due to be granted on the basis of lack of pattern, except those of Hereth, Orr and Jones, Inc.; Jack Hereth and Peter Orr.

This court also concludes that plaintiffs have no implied private right of action under Section 17(a). The recent trend of the courts which have considered the subject has been to hold that there is no such implied right. *See Scharp v. Cralin and Co.,* 617 F. Supp. 476, 478 (S.D. Fla. 1985); *Zelman v. Cook,* 616 F. Supp. 1121, 1128 (S.D. Fla. 1985); *Currie v. Cayman Resources Corp.,* 595 F. Supp. 1364, 1371 (N.D. Ga. 1984); *Delta Coal Program v. Libman,* 554 F. Supp. 684, 687 (N.D. Ga. 1982), *aff'd,* 743 F.2d 852 (11th Cir. 1984); *Sheftelman v. Jones,* 605 F. Supp. 549, 552 (N.D. Ga. 1984); *Fallani v. American Water Corp.,* 574 F. Supp. 81, 84 (S.D. Fla. 1983); *Summer v. Land & Leisure, Inc.,* 571 F. Supp. 380, 387 (S.D. Fla. 1983).

In *Landry v. All American Assur. Co.*, 688 F.2d 381, 384-89 (5th Cir. 1982), Judges Garza, Politz and Williams held that no such implied right exists. Plaintiffs have acknowledged that the matter is "up in the air," but that "we want to hold on to it." *Landry* contradicts plaintiffs' argument that the old Fifth Circuit recognized such a right. *Landry*, 688 F.2d at 384 n.9. Clearly the court did not decide the matter in *Phillips v. Alabama Credit Corp.*, 403 F.2d 692 (5th Cir. 1968), as the plaintiffs have speciously suggested. *John R. Lewis, Inc. v. Newman*, 446 F.2d 800, 803 n.2 (5th Cir. 1971) (Ainsworth, Judge). *See also Liberty National Ins. Holding Co. v. Charter Co.*, 734 F.2d 545, 561-567 (11th Cir. 1984) and *Touche Ross & Co. v. Redington*, 442 U.S. 560, 569-71 (1979). It is difficult for this court to ascertain, after considering the latter two cases, why the issue is as open in the Eleventh Circuit as the parties suggest. This court concludes that plaintiffs' claims pursuant to Section 17(a) are due to be dismissed.

This court, having addressed the various apparent embellishments of both sides, turns to the real issues in the case, i.e., is there evidence before this court sufficient to create a reasonable inference that the various defendants were guilty of conspiring to and engaging in a fraudulent scheme, with the requisite scienter as required by the opinion in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981).[9]

In considering what appears to be the real issue in the case, this court must be guided, *inter alia*, by the following observations in *Shores*.

> It would permit proof that the defendants engaged in an elaborate scheme to create a bond issue that would appear genuine but was so lacking in basic requirements that the Bonds would never have been

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[9]The court notes that little, if any, of the discussion in *Sklar* at 465 with reference to Harrelson and ASECo. has application in this case. Rice apparently *had been* successful in other projects and did have significant financial resources. The facts of this case cannot, under any view, be claimed to be nearly as severe as those depicted in *Sklar* at 465-67. Severe facts make law which is more difficult to apply to less severe facts. Each new principle of law breeds a multitude of cases premised on less severe facts than those which resulted in the establishment of the principle.

> approved by the Board nor presented by the underwriters had any one of the participants in the scheme not acted with intent to defraud or in reckless disregard of whether the other defendants were perpetrating a fraud.

647 F.2d at 468.

> Bishop's burden of proof will be to show that (1) the defendants knowingly *conspired* to bring securities onto the market, which were not entitled to be marketed, intending to defraud purchasers, (2) Bishop reasonably relied on the Bonds' availability on the market as an indication of their apparent genuineness, and (3) as a result of the scheme to defraud, he suffered a loss.

647 F.2d at 469-70 (emphasis added).

> If Bishop proves no more than that the bonds would have been offered at a lower price or a higher rate, rather than that they would never have been issued or marketed, he cannot recover.

647 F.2d at 470.

> Finally, we reject the contention that our holding imposes new burdens on defendants or enhances their liability. Lawyers, underwriters, and accountants who participate in bond issues in good faith are unaffected by our decision. Liability results only if they act with intent to deceive or defraud. None of these parties may be held liable for mere negligent performance of whatever role they choose to play, for the plaintiff must prove that the defendants acted with the requisite scienter.

647 F.2d at 471.

Plaintiffs argue, in a conclusory fashion, that "Plaintiffs have set forth a mountain of evidence that permits a jury to find the existence of a fraudulent scheme to market securities in violation of Rule 10b-5, and that bond counsel knowingly participated."

The following portions of plaintiffs' "mountain" create no reasonable inferences

(1) The mere issuance of the bond counsel opinion or the action of any other defendant "without which the bond issue

could not have been marketed." Such an allegation states nothing except that bond counsel and others did participate in the issue. The same can be said of the printer and the paper manufacturer. The role of each defendant must be examined beyond their usual involvement.

Of similar significance or lack thereof is that bond counsel performed legal work and prepared documents in connection with the closing that impacted on the underwriter, the promoter-developer and the non-profit corporation. Such actions in an effort to create an appropriate closing transcript, are not unusual. Little, if any, inference of fraud or conspiracy is thereby created.[10]

Plaintiffs also argue that defendants restructed an unfeasible project previously abandoned. There is no evidence that the other projects allegedly deemed to be unfeasible were structured as was the subject project. What some lawyers deem to be meritless cases are sometimes taken by other lawyers who "ring the bell." Feasibility can relate both to marketability of the project units, marketability of the bonds, or sufficiency of bond proceeds to finance the project.

The project could be feasible as to marketing units but unfeasible as to marketability of bonds, sufficiency of proceeds, etc. While other parties connected with previously planned projects might be qualified to express expert opinions as to the feasibility of the project as ultimately planned, it is doubtful that evidence that previous similar projects were deemed to be unfeasbile would be relevant or, if relevant, that it would not be unduly prejudicial under Rule 403.

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[10]Plaintiffs close their argument on this point by stating: "In short [bond counsel] had its hand in every aspect of the bond issue." Such a hand is not unusual. If bond counsel had deferred to others such deference could be questioned as it has been in other instances in this case. Plaintiffs' emphasis upon bond counsel being paid $115,000,00 may have some jury "appeal," but creates no reasonable inference of fraud when a twenty-nine (29) million dollar bond issue is involved. Some of plaintiffs' counsel have already been paid $170,000.00 in connection with the bankruptcy proceedings and presumably intend to seek fees in this case. Does that, in and of itself, create an inference of bad faith?

The meat of the claim of fraudulent scheme are the allegations that Rice made fraudulent misrepresentations to serious potential purchasers and also created sham sign-ups to increase the number of indicated purchasers of units in the project, and that others knew of this or were reckless in not ascertaining it. Plaintiffs allege that the evidence shows that bond counsel knew of these actions when it issued its legal opinion permitting the marketing of the bond issue. Plaintiffs argue that the misrepresentations consisted of Rice and Robertson's representation to prospective project unit purchasers that the purchasers were entitled to an absolute refund should they decide to leave the project and that, in spite of this, the closing transcript included an agreement which subordinated such payments to the bond indebtedness. As evidence of bond counsels' knowledge of the foregoing, plaintiffs rely on a letter from Rice to bond counsel dated August 7, 1981 in which Rice states, *inter alia:*

> I personally do not understand that Section XX "Extent to Which Successors of Mount Royal Take Subject to This Occupancy Agreement." This section was not in the original draft of the Occupancy Agreement, representations of which we have been using in the marketing program. Nevertheless, I am relying upon Corporate Counsel and Bond Counsel's approval of the Occupancy Agreement and other related documents.

Plaintiffs further allege that Mt. Royal, with Rice's connivance and approval, began accepting deposit agreements without deposits, including those of employees and relatives who were assured that they had no actual obligation under the Occupancy Agreements. As to these latter allegations, plaintiffs state, in a vague manner, "[bond counsel] knew or should have known of and questioned the sham sales. . . .[11] There is no suggestion of any specific evidence on this point.[12]

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[11]Plaintiffs refer to the latter type sales as "sham sales" and, thus, apparently distinguish them from sales as to which it is alleged that misrepresentations with reference to refunds were made.

[12]The strongest evidence on this point is the statement in Laventhol's Feasibility Study at 45: "As of July 8, 1981, approximately 32% of the

The other primary evidence which plaintiffs rely upon to prove a fraudulent scheme is that Rice obtained an executed version of the Development and Marketing Contract dated March 1, 1981 that was different from the executed version included in the bond issuing closing documents. The March 1 agreement did not include a schedule of marketing which was incorporated into the closing documents. Further, Rice testified that *he* never reached an agreement as to any particular marketing schedule and that *he* did not intend to meet the schedule set out in the closing documents. Plaintiffs argue, "The Development and Marketing Contract bound in the closing transcript for the bond issue, however, contains an attached schedule of sales. *Rice thus admits he* never intended to bind himself to sell the apartments on a contractually specified schedule, although he obviously was willing to have *others* think this. . . ." (emphasis added). Presumably "others" includes at least some of the other defendants. However, undisclosed intent on Rice's part does not create a reasonable inference of fraud on the part of other defendants. It is not unusual to leave a schedule incomplete until there is a final agreement. The mere fact that Rice may have harbored an intent not to comply creates no reasonable inference of fraudulent scheme or conspiracy by other defendants, particularly when a contrary agreement was included in the closing transcript. It is not unusual for earlier drafts to be abandoned before closing.

Part of the fraud alleged is that the *bond counsel* delivered a legal opinion that the bonds were validly issued and tax exempt. Plaintiffs use a "tax exempt" market, rather than a bond market, as the basis of their claim of non-marketability. There is no evidence that any other defendant played a role in the making of this alleged fraudulent decision. There is no direct evidence nor substantial circumstantial evidence that this decision was made either on a conspiritorial basis or that any other defendant influenced bond counsel to make the

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residential units had been reserved; the underwriter intends that the series 1981 Bonds will be issued when approximately 50% of the residential units have been reserved." At the time of closing, it was made clear that this goal had not been reached. Appropriate caveats related to risk were given.

decision. For aught that appears all other defendants relied upon bond counsel's expertise in making this decision. Although the court has considerable doubt as to the appropriateness of a jury decision as to tax exemption *vel non*, in the face of an IRS determination, there is no evidence that bond counsel made its decision other than independently. In their briefs, plaintiffs make no suggestion that any other defendant participated in this decision. Plaintiffs only argue that "[a] jury could reasonably infer that [bond counsel] knowing (sic) or recklessly failed to disclose or correct this information. . . . "[13]

The separate letters of Perdue, Johnson, Boone and Johnson and Cabaniss, Johnston, et al, independent Alabama counsel, dated September 30, 1981, are comprehensive and include statements that various closing documents have been examined and that "We have also had discussions with officers of the Issuer and made such other indpendent investigations as we have deemed necessary for the purpose of rendering this opinion." The letters certify, *inter alia,* that:

> (a) The issuer is a public corporation and instrumentality of the State of Alabama, and is in good standing under the laws thereof, and has all necessary power and authority to enter into and perform its obligations under the Bonds, Loan Agreement, Indenture, Contract of Purchase, Mortgage and Mortgage Assignment, and to assign the Note to the Trustee.
>
> (c) The Loan Agreement, Indenture, Mortgage, Mortgage Assignment, and Contract of Purchase has each been duly authorized, executed and deliverd by the Issuer and each is a valid and legally binding obligation of the Issuer, enforceable in accordance with its terms, and the Note has been duly assigned and delivered by the Issuer to the Trustee and such assignment is valid and legally binding on the Issuer, enforceable in accordance with its terms.

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[13]Plaintiffs emphasize that this was the first project that Marietta, an attorney with bond counsel, ever worked on. This may be some suggestion of negligence, but not fraud. Marietta had experience with the I.R.S.

> (f) The execution, delivery and performance by the Issuer of the Bonds, Loan Agreement, Indenture, Contract of Purchase, Mortgage and Mortgage Assignment, and the assignment of the Note by the Issuer do not violate any provisions of the Act or any other applicable law of the State of Alabama and do not violate or cause a default under any agreement or instrument by which the Issuer is bound.

The letter of Coretti and Newsome, dated September 30, 1981, states:

> The User is a non-profit corporation duly organized under and *validly* existing by virtue of the laws of the State of Alabama, and is in good standing under said laws, and has full power and authority to execute and delivery the Loan Agreement, Note Mortgage, and Indemnity Agreement and to perform the obligations thereunder.

(Emphasis added).

There is no evidence that these attorneys were parties to any fraud, scheme or conspiracy, or that they were acting other than independently. Indeed, they have not been charged with such by the plaintiffs. There is no evidence as to why it was unreasonable or reckless for defendants to rely upon these letters. Unless there is compelling evidence that the issue was unquestionably not tax-exempt and that the parties knowingly conspired with reference thereto, this court should not submit this issue to the jury.

Plaintiffs have cited a number of cases in which it appears that juries were allowed to consider and determine some factual issues which may have led to the conclusion that bond interest was not tax exempt as represented. Such cases are not conclusive to a determination of whether there was a conspiracy or fraudulent scheme when the decision, as in the present case, was made by bond counsel and supported by letters from three independent law firms not named as defendants. I any event, there is no proof that any plaintiff has suffered any damage with reference to any alleged taxability of the bond interest. Although the theory of the action is a fraudulent scheme, there must be some nexus

between the alleged scheme and the damage. Otherwise, the element of causation is totally eliminated. *Shores* did not "decide whether a distinction should be drawn between the terms 'loss causation' and 'transaction causation.' " 647 F.2d at 469. Here, there is no evidence that the tax exempt representations caused any economic harm.

While this court recognizes that this is not a misrepresentation or omissions case, *per se,* surely the fact that the circumstances alleged to evidence the fraudulent scheme were not misrepresented in or omitted from the Official Statement, has a bearing on whether there is a reasonable inference of fraud. One must remember that in *Shores,* the Offering Circular itself contained significant and material misrepresentations and there were significant and material omissions therefrom. These misrepresentations and omissions formed the very basis of the alleged fraudulent scheme. It was the Board from whom these matters were alleged to have been concealed. There is no circumstance in this case, alleged to be the basis of the fraud (with the tenuous exception of the tax exemption claim), which was not fairly represented and disclosed in either the Official Statement or Feasibility Study.

In effect, the plaintiffs allege fraud on the basis of the failure to adhere to initial undertakings or to implement earlier plans. All of these changes or failures were disclosed in either the Official Statement or Feasibility Study.[14] This case is clearly distinguishable from *Shores* on at least two bases. The promoters and developers were not nearly as suspect and fair disclosures were made in either the Offering

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[14]In *Shores v. Sklar,* the issue was whether Bishop's failure to read the Offering Circular precluded his action notwithstanding the misrepresentations and omissions related thereto. The content of the Offering Circular was not deemed to be irrelevant to whether there was a fraudulent scheme. *Shores* states: "In essence, the complaint alleged that the defendants had *fabricated a materially misleading Offering Circular in order to induce the Board* to issue, and the public to buy, fraudulently marketed bonds." 647 F.2d at 464. (emphasis added). Interestingly, all parties that could have kept these bonds from being marketed, including the Board and the underwriter, are named as defendants. On the other hand, the brokers who sold the bonds to plaintiffs are not named. Presumably, they had access to the Official Statement.

Statement or Feasibility Study. This is not indicative of a "persavise scheme."

Shores is replete with allegations of misrepresentations of existing facts and material omissions.[15] In the present case, the plaintiffs primarily rely on the alleged lack of feasibility of the project when the bonds were clearly disclosed to be high risk bonds. The alleged misconduct primarily relate to failures to eliminate the risk or to tie down the success of the project before closing. Notwithstanding any prior unmaterialized undertakings, all the weaknesses were disclosed in the Official Statement or Feasibility Study.[16] The 17% non-taxable interest rate was, in and of itself, evidence of the high risk nature of the bonds. The brokers from whom plaintiffs purchased the bonds and others responsible for entry of the bonds into the market should have been alerted by this as well as the Official Statement and Feasibility Study. After extended discovery, plaintiffs do not call attention to any alleged fraud approaching the magnitude of that alleged in *Shores*. Obviously, if there had been no default or loss, plaintiffs would not be bringing this action. Defendants, however, did not act as insurers against the failure of the project. Mere failure of the project does not, in and of itself, create an inference of fraud.[17]

The real issue is, as follows:

Is the failure to have a fixed number of marketing agreements, with adequate deposits in hand at the time of closing, when there is no representation of such, fraud *per se*?

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[15]SEC had investigated and commenced a civil action against principals, (*Id.* at 465); misrepresentation of land ownership and development, (*Id.* at 466); misrepresentation of principals as being successful in business, (*Id.* at 466); misrepresentation of non-dependency of actions, *Id.* at 466; false financial statements, (*Id.* 466); over valuation of assets, (*Id.* at 466); trustee failed to demand cure of default (*Id.* at 467), (It is difficult for this court to see how such failure related to a fraudulent scheme to market).

[16]Attached hereto are excerpts from the Official Statement. This court has indicated with parentheses the particularly revealed risk factors which, in effect, are the matters now alleged to form the bases of the alleged fraudulent scheme.

[17]*Cf.* Alabama cases which hold that failure to perform, in and of itself, creates no inference of fraud.

If it is, plaintiffs are entitled to have their motions granted at least as to the underwriters, Rice and certain of his affiliates. If not, these defendants are entitled to summary judgment. This court should not allow a jury to decide *ad hoc* whether mere abandoned undertakings constitute a fraudulent scheme when the ultimate situation has been fairly disclosed.

The project having failed and a loss having occurred, it is not difficult by a series of re-examinations, second guesses and tracking of the progress toward closing to create a phantasmagoria which purports to support a conclusion of fraud. The real issue notwithstanding the sequence of events leading to the final package, is whether the final package itself "was so lacking in basic requirements that the Bonds would never have been approved by the Board nor presented by the underwriters had any one of the participants in the scheme not acted with intent to defraud or in reckless disregard of whether the other defendants were perpetrating a fraud." In this instance, bond counsel revealed the very matters which plaintiffs allege form the bases of the fraud. The risk inherent in the high rate bonds was revealed.[18] Neither the prospect of success nor the effort to achieve success was as tainted as was the situation in *Shores*.

Plaintiffs have not directly addressed, in any brief, defendants' argument that the bonds would have been marketable at some price whether tax exempt or not. The fact that plaintiffs have recovered a substantial part of their investment and that the project is even now being operated by a subsequent purchaser is some evidence that the project was neither a total sham nor totally unfeasible. *Shores* has been criticized by commentators even in the face of the blatant conduct depicted therein.[19] Courts should be slow to extend the doctrine to less severe circumstances. If the project had been unquestionably feasible and successful, *no* risk would

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[18]For a person in a 50% tax bracket, the effective rate approximates 34%.

[19]*See Lipton v. Documation*, 734 F.2d 740, 743 (11th Cir. 1984). *Lipton* states "the fraud on the market theory finds its greatest justification when applied to class actions alleging fraudulent misrepresentations or omissions that affected security prices on a developed open market."

have been involved and the bonds would have been effectively guaranteed. Capital is raised for purposes ranging from no specifically intended use, or as venture capital, all the way to bonds guaranteed by the United States. None of this is forbidden if there is full disclosure of the risk. Plaintiffs have not stated what they suggest the issue should have been short of absolute safety. If they were seeking absolute safety, their brokers had information available which would have militaged against purchase. Plaintiffs acknowledge that, if they had been given this information, they would not have purchased the bonds. The claims should be considered in light of the bonds as they were ultimately represented and sold. It is illusory to suggest that each departure from a previously considered step evidences fraud. If the defendants had guaranteed the project's success, plaintiffs would have effectively been in a "no lose" situation. However, this was not the nature of the bonds as purchased or represented.

While the court has considered the accusations and allegations separately, it must also consider whether the evidence collectively indicates a pervasive scheme to defraud. Evidence of conspiracy and fraud must arise above mere suspicion. From the beginning, this court has cautioned the plaintiffs to present something other than conclusory allegations of *conspiracy*. Thus far, they have not been forthcoming. The conduct of particularly bond counsel and Laventhol apparently constituted "the daily grist of the mill." Mere evidence of the closing of a marginal project is not evidence of a *pervasive* scheme or conspiracy.

In effect, the plaintiffs have twisted action taken by bond counsel to inform prospective purchasers to reflect fraud on bond counsel's part. It is not unusual for bond counsel to require changes of matters initially contemplated by the other participants. There is no evidence that bond counsel was doing other than making requirements, notwithstanding Rice's desires.

This court has pondered this case over a number of months and has ultimately decided that the essence of the case is this:

Is it fraudulent to issue bonds to finance a project whose success is dependent upon the ultimate marketing of a minimum number of units when there have been no or minimal pre-sales of units and this fact is fairly revealed in the various disclosing documents? A subsidiary question is whether an initial unsuccessful effort to pre-sell units should cause the issue to be considered any differently than if there had been the same type closing without a previous effort to pre-sell. A supplemental question is whether, in the face of undisputed facts, juries should decide such issues on an *ad hoc* basis. A question related to the latter is whether the less severe facts of this case are sufficient, as a matter of law, to rise, under any view, to a pervasive scheme of fraud under the holding in *Shores*. Another related question is whether the evidence rises to the level of creating a reasonable inference of conspiracy, in any event, when there is no direct evidence of conspiracy and the only evidence is that the parties closed the issue with knowledge of facts as disclosed in the Official Statement.

There is a distinction between holding that juries must determine disputed facts and holding that juries are to make *ad hoc* decisions when the facts are undisputed.

In the present case, there is little dispute that the defendants attempted to pre-market units, that their effort was unsuccessful, and that, despite their unsuccessful effort, they closed the issue, with fair disclosures. Further, there is little dispute that the project was not so bogus as to be a total sham, and was salvaged with no out of pocket loss to the bondholders, although with a significant loss of use of their funds.

This court has concluded that, as a matter of law, such an undertaking cannot be considered to be a pervasive fraud of the type required by *Shores*. Expedience might dictate dropping this issue in the lap of a jury. Judgment does not. If such an issue is always to be deemed fraudulent, it should be determined as a matter of law and not depend on a jury's whim. If the raising of risk capital is so forbidden, even in the face of disclosure, it should be forbidden with certainty, not caprice.

The court ultimately concludes that there is no evidence from which a jury could reasonably infer:

A *knowing conspiracy* to bring securities on the market which were not entitled to be marketed, intending to defraud purchasers; that the bonds could not have been offered at a lower price or higher rate; or that there was a pervasive fraudulent scheme to market the bonds.

The court initially refused to grant various motions to dismiss and for summary judgment filed by some of the defendants in order to allow additional time for discovery.[20] That time has come. *See Celotex Corp. v. Catrett, supra.* While the entitlement to summary judgment may be less clear as to Rice, his affiliates and the underwriter than as to bond counsel and Laventhol, this court has concluded that there is no reasonable inference of a pervasive scheme or conspiracy as to any defendant.

In view of this court's underlying conclusion that there is no evidence of a pervasive scheme to defraud or a conspiracy, this court does not address the issue of control *vel non* as to the trustees and other defendants. This issue should likely be addressed on appeal in the event of a reversal as the underlying issue.

An appropriate judgment will be entered.[21]

This the 18 day of August, 1986.

/s/ Robert B. Propst

ROBERT B. PROPST
UNITED STATES DISTRICT JUDGE

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[20] The court has been concerned from the beginning with the scattergun allegations that every party (with the exception of Birmingham counsel) which had any involvement with the bond issue was privy to a pervasive scheme to defraud. Nevertheless, the court allowed, perhaps unduly so, additional discovery.

[21] One of the plaintiffs' motions attempts to have this court determine, as a matter of law, that certain attorneys not partners of bond counsel at the time of closing are subject to liability. Under the circumstances, it is unnecessary for this court to directly consider this issue. However, it appears that it would be inappropriate to decide it as a matter of law in any event.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

ERNEST ROSS and GEORGE MILLER, Individually and as representatives of a bondholder class,	)	
Plaintiffs,	)	
v.	)	CONSOLIDATED CIVIL ACTION NOS. CV85-PT-0444-S CV85-PT-1044-S
ARTHUR RICE, JR., et al.,	)	
Defendants.	)	

JUDGMENT

In accordance with a Memorandum Opinion filed contemporaneously herewith, the court denies all motions for summary judgment filed by plaintiffs and grants the motions for summary judgment filed by the following defendants:

Laventhol & Horwath — filed July 18, 1985

Arthur M. Rice — filed February 27, 1986

Peter Orr — filed March 4, 1986

Bond Counsel Defendants — filed April 9, 1986

William V. Weldon, James R. Rogers, James H. Blanton, A. L. Lee and Ida Moffett — filed April 22, 1986

John S. Schuler — filed May 14, 1986

R. O. Davidson — filed May 13, 1986

Jack Hereth — filed June 12, 1986

All claims and actions of the named plaintiffs against defendants, on whose behalf said above listed motions were

filed, are dismissed, with prejudice. Costs are assessed against named plaintiffs.[1]

The court further determines that there is no just reason to delay entry of final judgment with reference to the foregoing dismissal of the said claims and actions against said defendants and directs that the Clerk enter a final judgment of dismissal, with prejudice, with reference to said claims and actions as to all of said defendants.

The court further determines and declares that, as to any orders of this court which may be deemed to be interlocutory, including any denial of motion(s) for summary judgment or otherwise, there is a controlling question of law involved with respect to which there is substantial ground for difference of opinion and that an immediate appeal from those orders may materially advance the ultimate termination of the ligitation.[2]

Within 10 days, the plaintiffs will file with the court a document which reflects the names of any remaining defendants against whom plaintiffs wish to maintain an action, the status of any such actions, and the intent of plaintiffs with respect to pursuing any such claims or actions.

DONE and ORDERED this 18 day of August, 1986.

/s/ Robert B. Propst

ROBERT B. PROPST
UNITED STATES DISTRICT JUDGE

[1]It is the intention of the court to dismiss, with prejudice, all pending actions and claims of the named plaintiffs against all defendants who have filed motions for summary judgment.

[2]All of the issues in the case interlock and should be addressed together.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

ERNEST ROSS and GEORGE MILLER, Individually and as representatives of a bondholder class,	)	
Plaintiffs,	)	
v.	)	CONSOLIDATED CIVIL ACTION NOS. CV85-PT-0444-S CV85-PT-1044-S
ARTHUR RICE, JR., et al.,	)	
Defendants.	)	

ADDENDUM TO MEMORANDUM FILED
ON AUGUST 18, 1986

The court adds the following statement to its memorandum opinion as an observation which the court originally made and wrote and prepared as an insert, but which was misplaced and omitted from the opinion filed on August 18, 1986. The following should be added at the beginning of the second paragrah on page 24.

> If the effort made to pre-sell units had been successful and the bond counsel and underwriters could have so represented, the bonds may have been more acceptable to potential purchasers, and, thus *more* marketable. The fact, however, that the pre-sell effort was not successful, did not, in and of itself, make the bonds unmarketable if fair disclosure was made. The issue is whether the sale of the bonds

without pre-sales was fraudulent regardless of the effort to make pre-sales.

DONE and ORDERED this 22 day of August, 1986.

/s/ Robert B. Propst

ROBERT B. PROPST
UNITED STATES DISTRICT JUDGE

CERTIFICATE OF SERVICE

This is to certify that three (3) copies of the Petitioner's Supplemental Appendix to the Petition For Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit, have been served by United States mail, postage prepaid, and properly addressed upon counsel for Respondents: John E. Grenier, Charles C. Pinckney, Fred J. McCallum, Jr., Lange, Simpson, Robinson and Somerville, 1700 First Alabama Bank Building, Birmingham, Alabama; James H. Gewin, Samuel H. Franklin, Jay D. St. Clair, Bradley, Arant, 1400 Park Place Tower, Birmingham, Alabama 35203; Robert H. Adams, 1804 Seventh Avenue North, Birmingham, Alabama 35203; Kirk M. McAlpin, Jr., Attorney at Law, Peterson, Young, Self and Asselin, Suite 1100, 230 Peachtree Street N.W., Atlanta, Georgia 30303; Robert Wyeth Lee, Jr., Lee and Sullivan, Suite 300, 310 North 21st Street, Birmingham, Alabama 35203; Michael L. Edwards, Patricia McGee, Attorneys at Law, Blach, Bingham, P. O. Box 306, Birmingham, Alabama 35201; W. Michael Atchison, One Daniel Plaza, Daniel Building, Birmingham, Alabama 25233; Herbert P. Schlanger, Suite 900, 230 Peachtree Street N.W., Atlanta, Georgia 30303; William H. Mills, Redden, Mills and Clark, 940 First Alabama Bank Building, Birmingham, Alabama 35203; and William J. Cobb, H. Marshall Korschun, KOCHER, WILSON, LICHTENSTEIN AND COBB, Attorneys at Law, 1801 Peachtree Road, N.E., Suite 250, Atlanta, Georgia 30309; Charles L. Denaburg, Attorney at Law, 2125 Morris Avenue, Birmingham, Alabama 35205; and Mr. Jerre B. Swann, Attorney at Law, KILPATRICK AND CODY, Suite 3100 Equitable Building, 100 Peachtree Street, Atlanta, Georgia 30043.

This the 5th day of April, 1990.

Robert L. Wiggins, Jr.